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Majority of banks in Pakistan to meet Basel-III requirements comfortably: Mr. Yaseen Anwar

Mr. Yaseen Anwar, Deputy Governor, State Bank of Pakistan has expressed the hope that the majority of banks operating in the country will comfortably meet the new capital requirements as well as the liquidity standards of Basel-III. ‘However, SBP will continue to work with those banks that may face some problem in achieving the standard promptly,’ he added.

Inaugurating a three-day ‘SAARCFINANCE Regional Seminar on Basel-III and Policy Response in SAARC Countries’ at the National Institute of Banking and Finance (NIBAF), Islamabad today, he said that the banking sector of Pakistan enjoys a healthy capital adequacy ratio of 14% (aggregate) because of ‘our highly focused and strict banking supervision policies and oversight.’

‘This is a remarkable achievement given the fact that for the last two years the sector has faced a sluggish economic environment and a marked rise in overdue loans,’ he said adding, it now appears that most banks have sufficient capital buffers to manage moderate shocks in credit and market risks.

‘Over the years, our banking sector has witnessed a significant change from a wholly government owned structure to the majority being privately owned,’ he said and added that this shift was one of the main factors which led to improved performance of the overall banking sector, which is evident in increased Return on Assets (ROA) and Return on Equity (ROE) of the banking industry here, and the high growth in banking assets.

Moreover, we opened up our banking industry to foreign investors which provided benefits such as new sources of capital, funding, know-how and competition, he said. ‘As such, this has helped the domestic banks to compete with foreign banks who possessed well established systems & controls, thus improving the overall soundness of the total banking sector and promoting competitive environment,’ he added.

The SBP Deputy Governor said that we implemented the Basel II capital accord in 2008. ‘It helped in enhancing the quality of risk management by tying regulatory capital more closely to institutions' underlying risks and by requiring strong internal systems for evaluating credit and other risks,’ he observed. He said that under Pillar I, ‘we have adopted simple approaches and we feel that in the area of advances, our banks still have a lot to do to improve the IT systems and data capturing requirement.’

‘SBP has also addressed Pillars II and III. It has provided guidance on ICAAP (Internal Capital Adequacy Assessment Plan) to facilitate Pillar II (Supervisory review process) implementation in banks. Regarding Pillar III (market disclosure) banks’ disclosure requirement through published financial statements and other regulatory reports have been much expanded and thus strengthened over the years, he affirmed.

Mr. Anwar said that in the broad area of Risk Management, which ultimately feeds into the Basel implementation, SBP has put in place detailed guidelines for banks, namely on Risk Management (issued in 2003) Internal Control (2004), Country Risk (2004) General Policy Framework (2007) and Stress Testing (2005). ‘In addition, we issued guidelines on Internal Credit Rating System (2007) and by September 2010, 90% of corporate borrowers were internally rated by banks,’ he added.

‘This has gradually started improving the risk management practices at all banks under our oversight and will also help the banks which would opt for advance approaches in future,’ he said and added: ‘we have constantly been refining our regulatory and supervisory oversight through set of prudential regulations and other related instructions.’

‘For example, stress testing guidelines have been revised extensively and would be implemented in forthcoming months. This is in line with Basel III framework which provides for a bigger role for stress testing in the determination of capital buffers under Pillar 2,’ he added.

The SBP Deputy Governor said that keeping in view the increasing reliance on IT systems, most of the large banks have either already shifted to or are in the process of shifting to new core banking application which will specifically cater to the future technology related requirements. ‘However, there is still a lot to be done to further improve the IT systems as well as the procedure for capturing data so as to better enable our banks to meet the minimum data/ information requirement necessary for the effective implementation of the Basel capital accord “advance approaches” in a proactive and disciplined manner,’ he added.

Referring to recent global financial crisis, he observed that in the absence of a global financial regulator, it proved difficult to ensure the safety and soundness of globally active financial institutions; and as such governments had to step in to bail out their respective institutions. ‘However, these “contagion” concerns can be minimized if we can keep local problems from turning global,’ he added

Mr. Anwar said that this would require both strengthening and harmonizing the financial supervision across the borders. Moreover, keeping in view the continuous upgrading of banking regulations and the challenges of adopting advance approaches, there is a need to have frequent interaction and cooperation among the regional countries, he said. ‘This will help us all if we can openly share our knowledge and experiences at regional forums such as this and also collectively devise ongoing and future strategies for region specific issues which may pose potential risks for each of our banking sectors,’ he added.

Mr. Anwar said that the main components of the new Basel framework are aimed at protecting against the types of internal and external shocks banks and banking systems often face, regardless of the state of development or complexity. He said the new framework substantially raises the quality and quantity of capital, with a greater focus on common equity. ‘With tangible common equity (TCE) which comprises paid up capital and retained earnings (minus intangibles), there would be an improvement in capital quality to better absorb losses from shocks which could emanate from anywhere,’ he added.

He further said that the crisis has shown that balance sheets were being leveraged, but the risk-based framework failed to fully or adequately capture this dynamic. Recognizing this problem, the Basel Committee has now introduced a simple, non-risk based leverage ratio to supplement the risk-based capital requirement that captures risks arising from total assets, he observed.

‘It introduces two types of capital buffers. The conservation buffer is oriented to absorb losses not only in normal times, but also during times of economic stress,’ he said and observed that additionally the countercyclical buffer takes into account the dangers of rapid credit growth, which might be particularly relevant for emerging economies.

‘Finally, beyond the need for more and better capital to absorb unexpected losses, the crisis highlighted the risk of poor liquidity management. As such another feature is the introduction of Liquidity buffers: for instance, banks must hold a sufficient position of high-quality liquid assets to allow them to survive a whole month’s loss of access to funding markets,’ he added.

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